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Fiscal Note & Local Impact Statement

Bill: S.B. 22 of the 132nd G.A. **Status:** As Passed by the Senate

Sponsor: Sen. Peterson **Local Impact Statement Procedure Required:** No

Subject: To incorporate recent changes to federal adjusted gross income into Ohio law

State & Local Fiscal Highlights

- Personal income tax revenue would be affected by an indeterminate amount during FY 2018 and years thereafter based on the provisions in this bill. Based on preliminary analysis, LSC economists believe that revenue is more likely to increase than decrease. Preliminary estimates by executive branch agencies suggest the revenue impact will not be major.
- The state income tax revenue change, if any, would be shared by the state General Revenue Fund (GRF, 96.66% in FY 2019 and 96.68% thereafter), the Local Government Fund (LGF, 1.66%), and the Public Library Fund (PLF, 1.68% in FY 2019 and 1.66% thereafter). Funds deposited into the LGF and PLF are distributed to counties, municipalities, townships, and public libraries according to statutory formulas and decisions by county budget commissions.
- Ohio Taxable Income (OTI) serves as the tax base for one of the two types of School District Income Tax. The modification of federal adjusted gross income incorporated by this bill may affect OTI by indeterminate amounts for affected school districts.

Detailed Fiscal Analysis

The definition of federal adjusted gross income (FAGI) in the Internal Revenue Code was modified on multiple occasions by federal lawmakers since March 30, 2017, and these actions affect the tax base for some Ohio taxpayers. The Tax Cuts and Jobs Act (TCJA), H.R. 1 of the 115th Congress, modified FAGI, which is the starting point for determining Ohio's personal income tax base. Most of the changes made by TCJA are effective for tax years starting after December 31, 2017, thus the bulk of state revenue effects would start with tax year 2018 (FY 2019). Given the extent and complex nature of these changes, and the confidential nature of individuals' tax returns, LSC cannot provide a precise estimate of the state revenue effect of incorporating these FAGI changes into state law. A spokesman for the Office of Budget and Management (OBM) reports that neither OBM nor the Department of Taxation so far has found reasons to believe that the federal tax cuts will have a major impact on Ohio finances.

S.B. 22 incorporates recent changes to FAGI that affect the Ohio income tax base. Some of these changes are temporary, scheduled to sunset after 2025; because the changes last for the next several biennia, the temporary nature is ignored for current purposes.

The following provisions would tend to increase FAGI for some Ohio taxpayers, thereby likely having the effect of increasing Ohio income tax revenue:

- **Limit on pass-through entity losses:** The bill limits the amount of the distributive loss of a pass-through entity (PTE) that a PTE investor may claim in a taxable year, to $250,000 ($500,000 for joint filers). Any remaining loss may be carried forward as a net operating loss (NOL).
- **Limit net interest deduction:** The bill limits the existing deduction for net business interest expense to no more than 30% of the business's adjusted taxable income.
- **Modification of NOL deduction:** The bill limits the NOL deduction for a given year to 80% of taxable income, and modifies associated carryback provisions.
- **Moving expenses:** The bill repeals a deduction that was allowed for moving expenses incurred by a taxpayer that relocates for work.[1] In addition, employer reimbursements to employees for moving expenses that would otherwise qualify for the moving expense deduction will no longer be excluded from employees' incomes.
- **Treatment of alimony:** Previously, alimony was treated as income by the recipient and deductible for the payer. Under the bill, alimony is not considered income for the recipient, and is not deductible by the payer. Because the amounts involved would in future be taxable to the alimony payer, who is typically subject to higher marginal income tax rates than the payee, this would tend to increase revenue.
- **Re-characterization of Roth IRA conversions:** Previously, if a person converted a traditional IRA to a Roth IRA, they could reverse (re-characterize) that decision (return those contributions to a traditional IRA). Generally, when money is converted from a (pre-tax) traditional IRA to an (after-tax) Roth IRA, the transaction is taxable – unless the money is converted back to a traditional IRA within a given period of time. The bill prohibits these types of re-characterizations.
- **Exclusion for bicycle commuting reimbursements:** Previously, up to $20 of the amount an employer reimburses its employee for bicycle commuting expenses could be excluded from the employee's income. The bill suspends this exclusion.

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[1] The repeal does not apply to members of the armed forces.

The following provisions would tend to decrease FAGI for some Ohio taxpayers, thereby likely having the effect of decreasing Ohio income tax revenue:

- **Newly eligible expenditures for 529 College Savings Plans:** The TCJA permits 529 account owners to use distributions from 529 plans to pay K-12 tuition and other education expenses up to $10,000 per student, per year, for enrollment at public, private, or religious elementary or secondary schools. Absent the conformity authorized by S.B. 22, these K-12 tuition payments from 529 plans must be added back to Ohio Adjusted Gross Income (OAGI).
- **Other changes affecting business income:** The TCJA extends and expands bonus depreciation, increases section 179 expensing to $1 million, expands "qualified property" for purposes of section 179 expensing, and makes changes to certain accounting rules for small business.

Please note that the list above is not exhaustive as TCJA includes numerous other provisions that may affect Ohio income taxes to a lesser degree.

Several of the changes affect the tax treatment of business income, but Ohio no longer has a corporate income tax, and only a fraction of taxpayers under Ohio's personal income tax still pay state tax on their business income. Continuing Ohio law allows a personal income tax deduction for the first $250,000 (joint filers) or $125,000 (single) of business income, and taxes business income at levels above these thresholds at a flat 3% rate. The TCJA changes to business income would not change Ohio income tax liabilities for a substantial majority of taxpayers who take the Ohio business income deduction. Determining the revenue effects of the changes to tax treatment of business income is the primary difficulty in accurately estimating the revenue effects of the bill.

LSC economists will continue to analyze the bill's provisions in consultation with officials of OBM and the Department of Taxation. As of this writing, LSC economists think the bill is more likely to increase state tax revenue than decrease it.

The Local Government Fund (LGF) receives 1.66% of all GRF tax receipts, and the Public Library Fund (PLF) receives 1.68% of those receipts in FY 2019 and 1.66% thereafter. Ohio Taxable Income (OTI) serves as the tax base for one of the two types of school district income tax. The modification of FAGI incorporated by this bill may affect the tax base by minimal, albeit indeterminate, amounts for affected school districts that use OTI as their tax base.

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